

**REDUCING THE DEFICIT:
SPENDING AND REVENUE OPTIONS**

The Congress of the United States
Congressional Budget Office

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Dashes in tables in this report indicate amounts less than \$2.5 million.

Details in the text and tables of this report may not add to totals because of rounding.

The Balanced Budget and Emergency Deficit Control Act of 1985 is also referred to in this volume more briefly as the Balanced Budget Act.

PREFACE

The Congressional Budget Office (CBO) is required by section 202(f) of the Congressional Budget Act of 1974 to submit an annual report on budgetary options to the Senate and House Committees on the Budget. This year, the report is in two parts, with this report constituting Part II. Part I is entitled *The Economic and Budget Outlook: Fiscal Years 1988-1992*.

This report provides background information for each major spending area of the budget and for revenues, and analyzes various specific options that would reduce the deficit. The inclusion of an option in the report, or the omission of one, does not imply a recommendation by CBO.

All divisions of the Congressional Budget Office contributed to this report, which was prepared under the supervision of Robert W. Hartman. Alfred B. Fitt was responsible for Section I. John D. Mayer, Maureen McLaughlin, Roger Hitchner, Jenifer Wishart, Earl A. Armbrust, and Rosemarie Nielsen were responsible for coordinating the specific deficit reduction options in Section II of this volume. Budget authority and outlay estimates were coordinated by Charles E. Seagrave, Robert A. Sunshine, Michael A. Miller, and William P. Myers. Revenue and outlay projections were prepared under the supervision of Rosemary D. Marcuss and Paul N. Van de Water, respectively. The Joint Committee on Taxation provided estimates of most of the revenue options.

Paul L. Houts supervised the editing and production of the report, assisted by Nancy H. Brooks. Major portions were edited by Patricia H. Johnston, Francis S. Pierce, and Sherry Snyder. Others who assisted in preparing the manuscript for publication were Mary V. Braxton, Jill Bury, Gwen Coleman, G. William Darr, Antoinette V. Foxx, Shirley G. Hornbuckle, Patricia A. Joy, Norma A. Leake, Angela Z. McCullough, Betty J. Miles, Ronald Moore, and Kathryn Quattrone. Additional assistance was provided by Shelbah Adams.

Rudolph G. Penner
Director

January 1987

CONTENTS

SECTION I	REDUCING THE DEFICIT: AN OVERVIEW	3
	The Context for Making Budget Decisions	4
	Uses of This Volume	8
SECTION II	SPENDING AND REVENUE OPTIONS	11
	National Defense	13
	DEF-01 Cancel Procurement of the F-15	20
	DEF-02 Cancel the C-17 Program	22
	DEF-03 Cancel the Antisatellite Missile	24
	DEF-04 Cancel Trident Refit Program	26
	DEF-05 Slow Trident SSBN Construction	28
	DEF-06 Restructure the Army's Forward Area Air Defense Program	30
	DEF-07 Defer New Program Starts Until 1990	32
	DEF-08 Reduce Purchases of MX Missiles	34
	DEF-09 Cancel V-22 Aircraft Development	36
	DEF-10 Restructure the Army Helicopter Programs	38
	DEF-11 Delay the Army's Deep-Attack Weapons	40
	DEF-12 Limit Funding for Supporting Procurement	42
	DEF-13 Alter Research and Development Funding	44
	DEF-14 Slow Growth in the Strategic Defense Initiative	46
	DEF-15 Alter Funding for Military Construction	48
	DEF-16 Retire Some G-Model B-52 Strategic Bombers Early	50

DEF-17	Alter Operation and Maintenance Funding	52
DEF-18	Reduce Active-Duty End Strength to 1982 Level	54
DEF-19	Slow the Growth in Army Active Guard and Reserve Personnel	57
DEF-20	Limit Military Pay Raise	59
DEF-21	Raise Cost-Sharing for Certain Outpatients	61
Entitlements and Other Mandatory Spending		63
ENT-01	Recalculate Medicare's Prospective Payment Rates Using More Recent Cost Data	68
ENT-02	Reduce Medicare's Payments for the Indirect Cost of Medical Education	70
ENT-03	Reduce Reimbursements for Capital Expenditures Under Medicare	72
ENT-04	Reduce Total Medicare Direct Medical Education Payments	76
ENT-05	Adopt a Fee Schedule for Reimbursing Physicians Under Medicare	78
ENT-06	Include Hospital-Based Physicians' Services in Hospitals' Prospective Payments	81
ENT-07	Increase Medicare's Premium for Physicians' Services	83
ENT-08	Use the Tax System to Impose a Supplementary Income-Related Premium for Physicians' Services	85
ENT-09	Tax a Portion of Medicare Benefits	87
ENT-10	Increase Medicare's Deductible for Physician Services	89
ENT-11	Cap Each Enrollee's Copayment Liability Under Medicare and Impose a Tax on "Medigap" Policies	90

ENT-12	Limit Federal Payments for Long-Term Care	92
ENT-13	Tax Employer-Paid Health Insurance	94
ENT-14	Restrict Cost-of-Living Adjustments in Non-Means-Tested Benefit Programs	97
ENT-15	Reduce the Replacement Rate Within Each Bracket of the Social Security Benefit Formula	102
ENT-16	Eliminate Social Security Benefits for Children of Retirees Aged 62-64	104
ENT-17	Eliminate Certain Veterans' Compensation Payments for Those with Low-Rated Disabilities or End Allowances for Dependents	105
ENT-18	Require a Two-Week Waiting Period for Unemployment Insurance Benefits	107
ENT-19	Index the Unemployment Insurance Taxable Wage Base	109
ENT-20	Maintain the Current Federal Unemployment Insurance Tax Rate	111
ENT-21	Reduce and Retarget Aid for Dependent Care	112
Agricultural Price Supports		115
AGR-01	Reduce Deficiency Payments by Lowering Target Prices	117
AGR-02	Increase Requirements for Unpaid Acreage Reduction	119
AGR-03	Target Income Support Payments Toward Specific Groups of Producers	120
AGR-04	Limit the Uses of Generic Commodity Certificates	122
AGR-05	Raise Domestic Prices of Supported Agricultural Commodities	124
AGR-06	Reduce Effects of Income Support Payments on Production Decisions	125

Nondefense Discretionary Spending

NDD-01	Reduce Federal Support for Agricultural Research and Extension Activities	131
NDD-02	Reduce New Lending or Increase Homeowners' Payments Under Rural Housing Loan Program	132
NDD-03	Reduce Funding for Research Supported by the National Institutes of Health	134
NDD-04	Reduce Subsidies Provided by the Rural Electrification Administration	135
NDD-05	Reduce Federal Funds for Research and Development in Energy Supply and Conservation	137
NDD-06	Eliminate Energy Conservation Grants	139
NDD-07	Change Revenue-Sharing Formula from a Gross to a Net Receipt Basis for the National Forest Timber Sales Program	140
NDD-08	End Funding for the Legal Services Corporation	142
NDD-09	Shift Housing Assistance from New Construction to Vouchers	143
NDD-10	Phase Out Subsidies for Flood Insurance and Crop Insurance	145
NDD-11	Convert Underused Acute-Care Beds in VA Hospitals	148
NDD-12	Recover the Operating Costs of Selected Regulatory Agencies	150
NDD-13	End Direct and Indirect Postal Subsidies	152
NDD-14	Eliminate Federal Support to States for Construction of Sewage Treatment Plants	154
NDD-15	Reduce Credit Subsidies to Federal Power Marketing Administrations	156

NDD-16	Transfer Control and Financing of Water Resources and Transportation Programs to Users and Local Authorities	158
NDD-17	Eliminate Funding for Untargeted Elementary and Secondary Education Programs	163
NDD-18	Reduce Campus-Based Student Aid	165
NDD-19	Eliminate or Restrict Eligibility for Community Development Block Grants	167
NDD-20	End Funding of the Economic Development Administration and Urban Development Action Grants	169
NDD-21	Cancel the NASA International Space Station Program	171
NDD-22	Cancel Funding for a Space Shuttle to Replace the Challenger	173
NDD-23	Eliminate Purchases for the Strategic Petroleum Reserve	175
NDD-24	Modify the Davis-Bacon Act by Raising the Contract Threshold and Allowing Unrestricted Use of Helpers	177
Federal Work Force		179
FWF-01	Alter the Timing and Distribution of Federal Pay Raises	183
FWF-02	Cap Cost-of-Living Adjustments for Federal Retirees Under Age 62	185
FWF-03	Modify the Federal Employees Health Benefits Program	188
FWF-04	Reduce Federal Travel Expenses	190
FWF-05	Trim the Size of the Federal Civilian Work Force	192

Revenues	195
REV-01 Raise Marginal Tax Rates for Individuals and Corporations	199
REV-02 Amend or Repeal Indexing of Income Tax Schedules	203
REV-03 Impose a Value-Added Tax	205
REV-04 Increase Energy Taxes	209
REV-05 Increase Excise Taxes	213
REV-06 Repeal Exemptions to the Gasoline Excise Tax	216
REV-07 Reduce Tax Credits for Rehabilitation of Older Buildings	218
REV-08 Tax Credit Unions Like Other Thrift Institutions	219
REV-09 Repeal Tax Preferences for Extractive Industries	220
REV-10 Eliminate Private-Purpose Tax-Exempt Bonds	224
REV-11 Tax Capital Gains at Death	226
REV-12 Tax 30 Percent of Capital Gains from Home Sales	228
REV-13 Decrease Limits on Contributions to Qualified Pension and Profit-Sharing Plans	230
REV-14 Impose a 5 Percent Tax on the Investment Income of Qualified Retirement Plans and IRAs	233
REV-15 Further Restrict Deductions for Business Entertainment and Meals	235
REV-16 Limit Mortgage Interest Deductions	236
REV-17 Eliminate Deductibility of State and Local Taxes	239

	REV-18	Increase Taxation of Non-Means-Tested Entitlement Benefits	241
	REV-19	Tax Nonretirement Fringe Benefits	244
	REV-20	Broaden the Social Security Tax Base	247
APPENDIX		SUMMARY TABLE OF SPENDING AND TAXATION OPTIONS BY BUDGET FUNCTION	249
TABLES			
I-1		CBO Baseline Deficit Projections	4
I-2		Baseline Outlay Projections	5
II-1		Alternative Levels of Defense Spending	16
II-2		Levels of Defense Budget Authority Under Alternative Budget Plans and Strategies for \$20 Billion Reductions from Administration's Budget Request, Fiscal Year 1988, by Appropriation Account	18
II-3		Federal Work Force and Compensation: Fiscal Year 1987	180
II-4		Sample Calculation of a Value-Added Tax Base, 1986	208
FIGURES			
		Fiscal Year 1987 Defense Budget Authority by Appropriation Account	14
		National Defense Budget Authority, Fiscal Years 1948-1992	15
		National Defense Outlays as a Percent of GNP, Fiscal Years 1948-1992	15

	Composition of Entitlement Outlays by Type of Program, 1986	64
	Composition of Entitlement Outlays by Type of Expenditure, 1986	64
	Entitlement Outlays, 1965-1992	65
	Cumulative Growth Rates in Entitlement Outlays by Type of Expenditure, 1970-1992	66
BOX	Federal Spending Categories	6

SECTION I

REDUCING THE DEFICIT





SECTION I

REDUCING THE DEFICIT: AN OVERVIEW

The Balanced Budget and Emergency Deficit Control Act of 1985 (the Balanced Budget Act) instructs the 100th Congress to adopt a budget plan for 1988 with a deficit no larger than \$108 billion. But if the policies left in place by the 99th Congress are continued by its successor, the likely deficit for 1988 will be \$169 billion, as shown in Table I-1 on the next page.

Unless the maximum deficit targets prescribed in the Balanced Budget Act are amended, the budget resolution for 1988, which is due to be adopted by April 15, 1987, must close a gap of \$61 billion. ^{1/} That amount corresponds to a 5.7 percent cut in 1988 outlays or a 6.8 percent rise in revenues.

If all of the excess 1988 deficit is eliminated on the spending side of the budget, some programs must be hit much harder than the 5.7 percent mentioned above. This imbalance occurs because still other programs are constitutionally shielded from any reduction at all--interest on the debt, contract obligations, judgments against the United States, and so forth. Technical factors and political consensus insulate yet other programs as well. For example, the Balanced Budget Act protects so many programs--mainly entitlements--from contributing significantly to deficit reduction that CBO estimates the act's rules would force a 14 percent reduction in 1988 budget resources for national defense and a 20 percent cut in the unprotected nondefense programs. ^{2/}

As for the alternative of reaching the 1988 deficit target entirely by raising taxes, a 6.8 percent rise would mean total federal government reve-

-
1. The Balanced Budget Act permits the target to be exceeded by \$10 billion before spending reduction procedures are set in motion, but that leeway is not granted in preparing the budget resolution. It *must* aim for a deficit of no more than \$108 billion.
 2. CBO and the Office of Management and Budget (OMB) will make a joint estimate for 1988 in August 1987. It will take account of enacted legislation and other developments affecting the budget outlook and will average the estimates of the two agencies. The August report will almost certainly differ from CBO's current estimate of 1988 spending reductions called for by the Balanced Budget Act.

nues that year equal to 20.5 percent of projected Gross National Product (GNP), a higher percentage than any other year since World War II. Such a rise is the equivalent of a 16 percent personal income surtax.

THE CONTEXT FOR MAKING BUDGET DECISIONS

Table I-2 shows actual outlays by major category for 1985 and 1986, together with the CBO projection of those outlays for the following six years. (The major categories are described in the accompanying box.) The most important message to be found in the table is that federal spending, which had been rising as a proportion of GNP, is expected to decline if current policies are continued. This reversal occurs largely because defense appropriations, having had high real growth in recent years, are now assumed to stay constant in real terms, and because projected interest rates are substantially lower than those experienced earlier in the 1980s. To the extent that the 100th Congress reaches budget targets with less spending than that shown in the baseline, the federal share of GNP will be correspondingly less.

TABLE I-1. CBO BASELINE DEFICIT PROJECTIONS
(By fiscal year)

	<u>Actual</u> 1986	<u>Base</u> 1987	<u>Projections</u>				
			1988	1989	1990	1991	1992
Outlays	990	1,008	1,069	1,124	1,184	1,247	1,305
Revenues	-769	-834	-900	-962	-1,050	-1,138	-1,220
Deficit ^{a/}	221	174	169	162	134	109	85
Target Deficit ^{b/}	-172	-144	-108	-72	-36	-0	n.a.
Excess Deficit	49	30	61	90	98	109	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. For the economic assumptions used in deriving the projected deficits, see CBO, *The Economic and Budget Outlook: Fiscal Years 1988-1992* (January 1987).

b. The maximums as prescribed in the Balanced Budget Act.

The table also discloses the severity of long-range spending cuts that must be made if the Balanced Budget Act's 1991 zero deficit target is to be met with no changes in baseline revenues. Under those circumstances, outlay growth from 1987 to 1991 can be only \$130 billion instead of the \$239 billion growth that would follow from adhering to current policy. Unless laws are changed, entitlements alone--mainly Social Security and Medicare--are projected to grow by \$136 billion from 1987 through 1991, implying negative growth in nominal dollars for defense, interest, and everything else.

On the other hand, if the 1991 zero deficit target is met solely by raising taxes, the probable required share of GNP for federal revenues would

TABLE I-2. BASELINE OUTLAY PROJECTIONS
(By fiscal year)

Major Category	Actual		Projections					
	1985	1986	1987	1988	1989	1990	1991	1992
In Billions of Dollars								
National Defense	253	273	280	290	303	317	332	346
Entitlements and Other								
Mandatory Spending	440	456	481	512	544	578	617	660
Nondefense Discretionary								
Spending	172	171	166	185	193	204	213	220
Net Interest	129	136	135	141	147	152	155	154
Offsetting Receipts	-48	-47	-53	-59	-63	-66	-70	-75
Total	946	990	1,008	1,069	1,124	1,184	1,247	1,305
As a Percent of GNP								
National Defense	6.4	6.6	6.4	6.2	6.0	5.9	5.7	5.6
Entitlements and Other								
Mandatory Spending	11.2	11.0	10.9	10.9	10.8	10.7	10.7	10.7
Nondefense Discretionary								
Spending	4.4	4.1	3.8	3.9	3.8	3.8	3.7	3.6
Net Interest	3.3	3.3	3.1	3.0	2.9	2.8	2.7	2.5
Offsetting Receipts	-1.2	-1.1	-1.2	-1.3	-1.2	-1.2	-1.2	-1.2
Total	24.0	23.8	22.9	22.8	22.3	21.9	21.5	21.1

SOURCE: Congressional Budget Office.

NOTE: Includes Social Security outlays, which are off-budget.

FEDERAL SPENDING CATEGORIES

National Defense. Outlays for military and civilian personnel, operating costs, weapons procurement, research and development, and military construction.

Entitlements and Other Mandatory Spending. Programs in which spending is governed by a law making all who meet their requirements eligible to receive payments. Subcategories are:

Health Care. Includes outlays for Medicare and for the federal share of Medicaid expenditures.

Social Security and Other Retirement and Disability Programs. Includes old-age, survivors, and disability benefits under Social Security, as well as other federally financed retirement and disability programs, including federal civil service and military retirement and disability programs, veterans' pensions and compensation, and Supplemental Security Income.

Other Entitlements and Mandatory Spending. Entitlements and other mandatory spending not included above. Major examples are: non-means-tested or partially means-tested benefits such as Unemployment Insurance and child nutrition; means-tested benefits such as Food Stamps and Aid to Families with Dependent Children; certain state and local grants such as the Social Services Block Grant; and agricultural price supports.

Nondefense Discretionary Spending. All nondefense programs for which spending is determined by annual appropriations, or by loan or obligation limits imposed in appropriation acts. The basic governmental legislative, judicial, and tax-collecting functions are included. A large part of this category represents the salary and expense accounts that finance the ongoing operations of the civilian agencies of government. Most grants to state and local governments (other than for benefit payments) and nondefense research and development are also in this category.

Net Interest. Interest payments on the federal debt, less interest received by trust funds and other interest payments to the federal government.

Offsetting Receipts. Proprietary receipts from the public and the employer share of employee retirement. Other receipts (for example, foreign military sales, trust fund receipts, and payments to trust funds) appropriately netted against outlays are included in the relevant categories above.

exceed 21 percent, higher than the peak reached in World War II. The exact percentage needed would depend, of course, on when taxes were raised.

The figures in Table I-2 also suggest that current policy means the absence of any dramatic shifts over the next five years among the major categories, but the aggregates conceal a large program that has replaced interest on the national debt as the one whose federal costs are growing most rapidly: farm income stabilization. In the five years ending with 1982, annual outlays for that purpose averaged about \$10.3 billion. In the next five years, the annual average grew to \$22.9 billion, and CBO now projects the average for the 1988-1992 period will be \$24.5 billion. For this reason, Section II includes a special discussion of the farm stabilization program.

Sale of Assets

Although the sale of assets by the government reduces the deficit under current accounting conventions, this report does not include any options that have the primary purpose of lowering the deficit with sale proceeds. The omission is not because such sales are always inappropriate; indeed, the sale of surplus federal property is a common and thoroughly appropriate activity. Moreover, the sale of newly created federal assets that are financial instruments--like loans to students or small business firms--would provide valuable market signals about their true value to the government and the real cost of the subsidy currently being conveyed to the borrower. (Sales of loans made in prior years have no particular use as a measuring rod since the subsidy has long since been granted.)

Most such sales do nothing, however, to ameliorate the long-term deficit. They produce some welcome cash in the sale year, but they do not make a contribution to narrowing a chronic gap between spending and revenue. The asset sale may be attractive in the short term, but only at the price of giving up future revenues that the asset would have generated for the government. In short, current deficit relief by this means may well lead to a still more vexing deficit problem later on.

Another point about asset sales is that they squeeze credit markets in almost the same fashion as borrowing by the government. The amount paid for the asset is no more available for private investment than is a like amount loaned to the Treasury. Thus, it is more appropriate to debate asset sales under such rubrics as privatization, efficiency, and management reform than in the context of long-term deficit options.

In many cases, the debate may lead to a conclusion in favor of a sale. But there are strong arguments against counting the proceeds toward reducing the deficit; instead, they might well be counted as a means of financing the deficit, just as the sale of Treasury bonds is counted. This treatment would eliminate the distortions created by the current accounting of sale proceeds. 3/

USES OF THIS VOLUME

This report lists 97 options that the Congress may wish to consider as it grapples with the deficit problem; 77 involve spending cuts and 20 would add to revenues. For each option, there is a short description of the arguments for and against its enactment, together with the estimated savings or revenue gains for each of the years 1988 through 1992. 4/

The Congressional Budget Office does not make policy recommendations except in the narrow area of budget process, so the appearance of an item among the listed options cannot be taken as a CBO endorsement of its enactment. Similarly, the absence of an item should not be construed as CBO opposition to its passage. The list is simply a nonexhaustive compilation of measures already in the public domain, so to speak. While consideration of any one of them is virtually certain to cause controversy, none is intended to be so extreme as to be implausible.

Almost all of the options in this report have been considered by past Congresses and, by definition, have failed to be enacted. But something has to give if the 100th Congress is to meet the Balanced Budget Act's targets, so the list includes items known to be unpopular, or previously voted down in both Houses.

Section II of this report is in six parts, each one with a brief subject introduction followed by the options relevant to the part: defense, entitlements, farm price supports, the federal civilian work force, nondefense discretionary programs, and revenues.

-
3. For more discussion of this issue, see CBO, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1988* (forthcoming).
 4. The savings and gains are calculated against the CBO baseline, except for the defense options, where the reductions are from the program in the President's 1988 budget recommendations.